

**Final Order Denying Refund: 04-20200333**  
**Gross Retail Tax**  
**For the Years 2018 and 2019**

**NOTICE:** IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

**HOLDING**

The Department did not agree that Retailer established that it was entitled to a refund of sales tax paid on the purchase of cardboard balers, fuel pumps, or prescription drug dispensers because the items did not have a substantial effect on the cardboard, fuel, or drugs sold to Retailer's customers.

**ISSUE**

**I. Gross Retail Tax - Manufacturing Exemption.**

**Authority:** IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-5-3(b); *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *North Central Industries v. Ind. Dept. of State Rev.*, 790 N.E.2d 198 (Ind. Tax Ct. 2003); *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-10\(a\)](#).

Taxpayer argues that it is entitled to an additional refund of sales tax paid on the purchase of cardboard balers, fuel pumps, and pharmacy pill counters/dispensers on the ground that the items are directly used in the direct production of Taxpayer's products.

**STATEMENT OF FACTS**

Taxpayer is an out-of-state company in the business of operating retail stores including grocery stores and gas stations. Taxpayer operates business locations within Indiana. Taxpayer submitted a form GA-110L ("Claim for Refund") requesting the return of approximately \$500,000 in sales tax paid when Taxpayer bought various items. The Indiana Department of Revenue ("Department") reviewed the refund claim granting the claim in part and denying the claim in part. The Department denied approximately \$130,000 of the originally claimed amount.

Taxpayer disagreed with the Department's decision and submitted a protest to that effect. An administrative hearing was conducted by video conference during which Taxpayer's representatives explained the basis for the protest. This Final Order Denying Refund results.

**I. Gross Retail Tax - Manufacturing Exemption.**

**DISCUSSION**

Addressing questions both of fact and law, the issue is whether Taxpayer has established that it is entitled to a refund of sales tax paid on the purchase of cardboard balers, fuel pumps, pharmacy pill counters/dispensers because the purchase of these items is exempt under Indiana law.

**A. Indiana's Gross Retail Tax and Purchases Exempt From the Tax.**

**1. Indiana's Sales and Use Tax.**

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for

the tax on the transaction. IC § 6-2.5-2-1(b).

The general rule is that all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. [45 IAC 2.2-5-10\(a\)](#). Tangible personal property means personal property that: (1) can be seen, weighed, measured, felt, or touched; or (2) is in any other manner perceptible to the senses. IC § 6-2.5-1-27.

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a).

In effect and practice, the use tax is functionally equivalent to the sales tax. See *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

The general rule is that all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8\(a\)](#).

## 2. Indiana's Manufacturing Exemption.

The exemption which Taxpayer claims is found at IC § 6-2.5-5-4 and only applies to machinery, tools, and equipment directly used by the purchaser in direct production. *Id.* The regulation provides that the "manufacturing exemptions" apply with equal weight to "industrial processors." Machinery, tools, and equipment are directly used in the production process if they have an immediate effect on the article being produced. [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. [45 IAC 2.2-5-8\(c\)](#). An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." [45 IAC 2.2-5-8\(c\)](#), example (1).

Proper application of the exemption requires determining at what point "production" begins and at what point "production" ends. [45 IAC 2.2-5-8\(d\)](#) states:

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

The manufacturing exemption is found at IC § 6-2.5-5-3(b).

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

The companion regulation, [45 IAC 2.2-5-8\(c\)](#), explains:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

Finally, [45 IAC 2.2-5-8\(k\)](#) explains the nature of the required change.

"Direct production, manufacture, fabrication, assembly, or finishing of tangible personal property" is performance of a series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change, and it must result in a transformation of property into a different product having a distinctive name, character, and use. Operations such as compounding, fabricating, or assembling are illustrative of the types of operations which may qualify under this definition.

The issue is whether the specific items of equipment are exempt because the items are directly used in Taxpayer's production process and they have an immediate effect on the article being produced. IC §

6-2.5-5-3(b). The determining factor is identifying the point at which Taxpayer's production process is deemed to be end; in this particular case, the question is when is the production of pharmaceuticals, recycled cardboard, and the fuel sold to Taxpayer's customers complete.

### **3. What Does Indiana Law Require and What Must Taxpayer Establish?**

IC § 6-2.5-5-3, like all tax exemption provisions, is strictly construed against the taxpayer. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). Indiana law has long held that "[W]here [] an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 101 (Ind. Ct. App. 1974). 1 (citing *Conklin v. Town of Cambridge City*, 58 Ind. 130, 133 (1877)).

Nevertheless, the Department is also well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

Thus, in order for Taxpayer to prevail on the issue it raised in its claim for a refund of sales tax, Taxpayer is required to provide documentation explaining and supporting its challenge. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

#### **B. Taxpayer's Refund Claim and Items at Issue.**

Taxpayer maintains it is entitled to a refund of sales tax paid on the purchase of fuel pumps, cardboard balers, and automated pharmaceutical dispensers.

##### **1. Cardboard Balers.**

Much of the merchandise sold at Taxpayer's stores arrives in corrugated, cardboard boxes. After removing the merchandise, the empty boxes are first flattened and then placed in a cardboard baler. The baler crushes and wraps the cardboard in plastic or metal strapping. The resulting bale is sold to recyclers. Taxpayer states that it qualifies as an "industrial processor" because the cardboard is not in a marketable condition until the baling process is complete.

##### **2. Fuel Pumps.**

Taxpayer sells fuels to customers by means of customer operated fuel pumps. The pumps draw fuel from two different underground fuel tanks. One tank contains a high-grade fuel while the other tank draws low-grade fuel from a second tank. If the customer decides to purchase mid-grade fuel, the fuel pump combines fuel from both the first and the second tank.

Again, Taxpayer argues it is acting as an "industrial processor" when its pumps dispense mid-grade fuel on the ground that the pumps dispense a product which has undergone a substantial change "in both composition and character."

##### **3. Pharmacy Pill Counters/Dispensers.**

Taxpayer operates in-store pharmacies for which it purchased automated pill counters and dispensers. The devices label, fill, and sort prescription drugs. Taxpayer argues that it is entitled to a refund of sales tax paid on the purchase of the devices because they are "directly used in direct production" and because the manufacture of the pills is not complete until the retail customer receives the pills in their "final marketable form."

#### **C. Why Did the Department Deny the Refunds?**

The Department denied the refunds on the ground that Taxpayer "is not engaged in manufacturing or refining . . . ." The Department cited to [45 IAC 2.2-5-8\(k\)](#) which states that the claimant must be engaged in "[D]irect

production, manufacture, fabrication, assembly or finishing of tangible personal property" by means of an "integrated series of operations which places tangible personal property in a form, composition, or character different from that which it was acquired." The regulation states the property must undergo a "substantial change" which transform the original property into a different product which has a "distinctive name, character, and use."

The Department concluded that Taxpayer was not engaged in the production of pharmaceuticals, cardboard, or mid-grade fuel and therefore the pill counters, baler, and fuel pumps were not exempt from sales tax and Taxpayer was not entitled to the refund.

#### **D. Analysis and Conclusion.**

Taxpayer relies on the Indiana Supreme Court's decision in *Merchandise Warehouse Co., Inc. v. Indiana Department of State Revenue*, 87 N.E.3d 12 (Ind. 2017). In that case, the court found that "blast freezing" food constituted the last step in a process which resulted in the food product petitioner sold to its customers. *Id.* at 21. The court further found that the petitioner was engaged in process of producing blast-frozen food because the blast-freezing "represents the crucial final step in creating a distinct marketable good-blast frozen food." *Id.* The court analogized blast freezing food - placing it in a separate freezer area and forcing cold air around to blast-freeze it - to ripening bananas with ethylene gas. *Id.* at 20. The court found that the petitioner "receives an unfinished product and actively transforms it into a finished product." *Id.* at 20.

However, the Tax Court, in *North Central Industries v. Ind. Dept. of State Rev.*, 790 N.E.2d 198 (Ind. Tax Ct. 2003), the court disagreed with the petitioner who argued that packaging fireworks constituted direct production or manufacture of the fireworks. *Id.* at 201. The court held that the petitioner was not entitled to refund of sales tax paid on the purchase of a shrink-wrap machine because the machine did not cause a substantial change or transformation of the fireworks. *Id.* The petitioner "merely packages existing fireworks into boxes, then labels and shrink-wraps them." *Id.*

The issue here is whether Taxpayer is engaged in various activities which are employed in a production process which produces a "distinct marketable product" and that the baler, fuel pumps, and pill dispensers are "essential and integral" to producing that marketable product. *Id.* at 18 (citing to *Ind. Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 523-24 (Ind. 1983)).

As noted above, Taxpayer is required to establish that its interpretation of the exemption "is clearly within the exact letter of the law," *RCA Corp.*, 310 N.E.2d 96, 101 (Ind. Ct. App. 1974), because [IC 6-2.5-5-3](#) is "strictly construed against a taxpayer." *Tri-States*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999).

In this case, the Department does not agree that Taxpayer is engaged in a functionally "integrated production process" which alters Taxpayer's cardboard, motor fuel, and pills into a saleable product which is a distinctively different cardboard, fuel, or pill sold to its customer. As stated in [45 IAC 2.2-5-8\(k\)](#), the claimant is required to establish that it produced a product which is substantially different in "form, composition, or character" from the cardboard, fuel, and pills which it originally received.

The Department finds that the *North Central Industries* decision is almost directly on point in discussing, analyzing, and addressing the issues raised here by Taxpayer. In that case, the petitioner was not entitled to the production/manufacturing exemption because it was simply packaging fireworks. *North Central Industries*, 790 N.E.2d at 201. Similarly, Taxpayer is not manufacturing "other tangible personal property" but IS packaging goods it could well have sold in their original form. [IC § 6-2.5-5-3\(b\)](#).

The Department does not agree that the baler, fuel pumps, and pill counters have an immediate effect on the cardboard, fuel, or pills sold its customers as required under [45 IAC 2.2-5-8\(c\)](#). There is essentially no "substantial" difference between what Taxpayer receives (pills, fuel, cardboard) and what it sells to its customers. [45 IAC 2.2-5-8\(k\)](#).

#### **FINDING**

Taxpayer's protest is respectfully denied.

October 20, 2020

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